



DEFENSE CONTRACT AUDIT AGENCY
AUDIT REPORT NO. 6701-2002E21000005



October 31, 2002

PREPARED FOR: Administrative Contracting Officer
Defense Contract Management Agency
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SUBJECT: Report on Audit of Time and Material Proposal

REFERENCES: ACO: DCMAE-GZO
Relevant Dates: See Page 8

CONTRACTOR: Sky Aviation Services, Incorporated
8800 Essington Avenue
Philadelphia, PA 19153

REPORT RELEASE RESTRICTIONS: See Page 9

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SUBJECT OF AUDIT

As requested by DCMA Cleveland on September 16, 2002, we examined Sky Aviation Services, Incorporated's July 23, 2002 time and material proposal submitted in response to letter contract number DTFA01-02-C-04130 to determine if the proposed costs are acceptable as a basis to negotiate a fair and reasonable contract price. The \$536,157 proposal is for airport screening services. The company proposed a performance period of February 18, 2002 through November 19, 2002.

The proposal and related cost or pricing data are the responsibility of the contractor. Our responsibility is to express an opinion on the proposal based on our examination.

Also as requested, during the course of this proposal evaluation we performed a pre award review of Sky Aviation Services, Incorporated's accounting system to assure that Sky Aviation Services, Incorporated's system of accounting controls for accumulating costs under prospective Government contracts is adequate to provide costs that are reasonable, compliant with applicable laws and regulations, and subject to applicable financial control systems.

Sky Aviation Services, Incorporated is responsible for establishing and maintaining an adequate accounting system for accumulating costs under prospective Government contracts. Our responsibility is to express an opinion on the adequacy of the accounting system based on our examination.

EXECUTIVE SUMMARY

Our examination of the \$536,157 proposal disclosed \$330,759 of questioned costs, including the following significant items:

Loaded Labor	\$194,181
Other Direct Cost	<u>\$136,578</u>
Total	<u>\$330,759</u>

The significant issues described below should be considered in the negotiation process.

SIGNIFICANT ISSUES

1. The results are qualified because we have not received a technical evaluation on the proposed hours as discussed on page 2.
2. Costs proposed are overstated as follows:
 - a. Loaded labor costs by 49% because of numerous errors.
 - b. Other Direct Costs by 98% because of estimating deficiencies.

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SCOPE OF AUDIT

Except for the qualification discussed below, we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance that the proposal is free of material misstatement. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the amounts and disclosures in the proposal;
- assessing the accounting principles used and significant estimates made by the contractor;
- evaluating the overall proposal presentation; and
- determining the need for technical specialist assistance and quantifying the results of a government technical evaluation report.

We evaluated the proposed costs using the applicable requirements contained in the:

- Federal Aviation Administration's (FAAs) Administrative Management System (AMS).

The scope of our examination reflects our assessment of control risk and includes tests of compliance with applicable laws and regulations. We believe our examination provides a reasonable basis for our opinion. Our assessment of control risk considers that we have not specifically examined Sky Aviation Services, Incorporated's accounting system, timekeeping and labor distribution system nor its estimating system, and the related internal controls. However, we did perform a pre award survey of the offeror's accounting system during the course of this review and found significant deficiencies which are detailed in the Results of Audit section of this report.

QUALIFICATION

We were unable to determine the reasonableness of the proposed labor hours considering the requirements under the letter contract. Refer to Results of Audit, page 4, Note 3 for a detailed discussion of this element of the contractor's proposal. On September 19, 2002, during a teleconference between DCMA Cleveland, DCAA Headquarters, and the DCAA Field Audit Offices (FAOs) performing audits of the proposals, we discussed the need for technical assistance with Mr. Ken Freeze, Procuring Contracting Officer. We were advised that no provisions had been made by the Transportation Security Administration (TSA) for the performance of any technical evaluations of the subject proposal. We were unable to determine the reasonableness of the proposed labor hours by other audit procedures. A technical assessment of the reasonableness of the proposed labor hours is considered essential to the evaluation of the proposed labor hours under the letter contract. Therefore, the results of audit

are qualified to the extent that additional costs may be questioned based on a technical evaluation of the proposed labor hours. If a technical evaluation of the proposed labor hours is subsequently performed and the results materially impact our audit findings, and contract negotiations have not been completed, we will issue a supplemental report incorporating the results of the technical evaluation.

RESULTS OF AUDIT

In our opinion, the cost or pricing data submitted by the offeror is inadequate in part (see comments on page 4 and 5, Notes 2, 3, and 4. The proposal was prepared in accordance with appropriate provisions of the FAA Administrative Management System (AMS). Nevertheless, in our opinion, the lack of technical evaluation on the proposed labor hours discussed in the Qualification section of the report is significant enough to materially impact the results of the audit. Therefore, as discussed with Mr. Ken Freeze, Procuring Contracting Officer, by telephone on October 24, 2002, we recommend that contract price negotiations not be concluded until a technical assessment of the reasonableness of the proposed labor hours has been performed and considered by the contracting officer.

Additionally, it is our opinion that Sky Aviation Services, Incorporated's accounting system is inadequate for accumulating costs under prospective Government contracts. The contractor does not accumulate costs by job nor does it segregate direct from indirect costs or develop indirect rates. In addition, the contractor does not isolate unallowable costs or maintain a general ledger to determine costs by account. However, the contractor has an electronic timesheet system that is tied into their computer system which is supported by their payroll records. Only certain employees work on this contract. Therefore, the contractor is able to identify hours incurred on this contract. The loaded labor rates were evaluated and found to be reasonable. We were able to verify the incurred other direct costs to the contractor's supporting documentation.

Sky Aviation Services, Incorporated's proposed amounts and our audit results are presented below:

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	Proposed	Questioned	Difference (Note 1)	Note	Page
Clin					
0001A	Secondary Screener				
	10,008 hours X \$16.5 = \$165,132	784.25 hours X \$16.5 = \$12,940	9,223.75 hours X \$16.5 = \$152,192		
	6,200 hours X \$20.81 = <u>\$129,022</u>	6,200 hours X \$20.81 = <u>\$129,022</u>	<u>\$0</u>		
	\$294,154	\$141,962	\$152,192	2 & 3	4
0001E	Site Supervisor				
	2,697 hours X \$20.00 = \$53,940	324 hours X \$16.5 = \$6,480	2,373 hours X \$20.00 = \$47,460		
	1,800 hours X \$24.92 = <u>\$44,856</u>	1,800 hours X \$24.92 = <u>\$44,856</u>	<u>\$0</u>		
	\$98,796	\$51,336	\$47,460	2 & 3	4
0002A	Secondary Screener				
	\$0	20 hours X \$24.75 = <\$495>	20 hours X \$24.75 = \$495	2 & 3	4
0002E	Site Supervisor				
	\$0	8 hours X \$30.00 = <\$240>	8 hours X \$30.00 = \$240	2 & 3	4
0003A	Secondary Screener				
	89 hours X \$24.75 = \$2,203	24 hours X \$24.75 = \$594	65 hours X \$24.75 = \$1,609	2 & 3	4
0003E	Secondary Screener				
	24 hours X \$30.00 = \$720	8 hours X \$30.00 = \$240	16 hours X \$30.00 = \$480	2 & 3	4
	Math Error <u>\$784</u>	<u>\$784</u>	<u>\$0</u>		
	Subtotal	\$396,657	<u>\$194,181</u>		
			<u>\$202,476</u>		
0006	Other Direct Cost	<u>\$139,500</u>	<u>\$136,578</u>	<u>\$2,922</u>	4
	Total	<u>\$536,157</u>	<u>\$330,759</u>	<u>\$205,398</u>	5

< > Denotes Upward Adjustment

Explanatory Notes

1. The amounts in this column are presented solely for the convenience of the procurement activity in developing its negotiation objective. They represent only the arithmetic difference between the amounts proposed and related questioned and unresolved costs. You should not consider the amounts to be audit-approved or recommended amounts. DCAA does not approve or recommend prospective costs because the amounts depend partly on factors outside the realm of accounting expertise, such as opinions on technical and production matters.

2. Loaded Labor Rate

a. Summary of Conclusions:

We questioned \$194,181 of the loaded labor cost which results from the difference between the contractor's proposed loaded labor cost and the actual loaded labor cost.

b. Basis of Contractor's Costs:

The proposed loaded labor costs are estimated. Hours were estimated based on requirements of the contract (see note 3. below for a discussion of the proposed labor hours).

c. Audit Evaluation:

The actual labor rates of the employees working on the contract were determined from the payroll records as of September 21, 2002. Then, we calculated the actual payroll tax, workmen's compensation, and G & A rates from the contractor's 2001 corporate tax return, since it was the most current information available. We determined that an 8% profit rate was reasonable considering the scope of work. We consolidated the data to arrive at loaded labor rates for the secondary screener and site supervisor. Our review found that the contractor's actual billed rates of \$16.50 for the secondary screener and \$20.00 are reasonable.

d. Contractor's Reaction:

The contractor concurs with our findings.

3. Labor Hours

a. Summary of Conclusions:

We verified the proposed labor hours to the contractor's payroll records and found significant differences. The contractor had erroneously included hours in their proposal that were not incurred. We are unable to determine the acceptability of the proposed labor hours without a technical evaluation. The results of our examination are qualified due to lack of a technical evaluation, see Qualification paragraph on page 2 of this report.

b. Basis of Contractor's Cost:

The proposed labor hours are estimated.

c. Audit Evaluation:

The actual labor hours billed was verified to the contractor's electronic timekeeping system and to the contractor's vouchers through September 30. We used estimates based on September data to determine the anticipated hours through November 19. As discussed in the Qualification paragraph of this report, we were unable to determine the reasonableness of the proposed hours by other audit procedures. We requested technical assistance in evaluating the proposed hours. We were advised by Mr. Ken Freeze, Procuring Contracting Officer, during a teleconference on September 19, 2002 that the Transportation Security Administration (TSA) had made no provisions for a technical evaluation of the proposals.

d. Contractor's Reaction:

The contractor concurs with our findings.

4. Other Direct Cost

a. Summary of Conclusions:

We questioned \$136,578 of other direct cost which results from the difference between the contractor's proposed other direct cost and the actual other direct cost.

b. Basis of Contractor's Cost:

The contractor proposed an estimated \$15,500 of other direct cost each month for the 9 months the contract was expected to last for a total of \$139,500.

c. Audit Evaluation:

We determined that the contractor actually incurred \$2,922 of other direct cost based on their books and records. We traced 55% (\$1,596/\$2,922) to the contractor's supporting documentation.

d. Contractor's Reaction:

The contractor concurs with our audit findings.

We discussed factual matters concerning our findings with Frank King, Office Manager in an exit conference held on October 3, 2002.

CONTRACTOR ORGANIZATION AND SYSTEMS

1. Organization

Sky Aviation Services, Incorporated was incorporated in 1998 under the laws of the Commonwealth of Pennsylvania. The company provides janitorial, cleaning, and secondary screening services at Philadelphia International Airport. Sky Aviation Services, Incorporated had sales of approximately \$300 thousand in fiscal year 2001 and employs approximately 20 people.

2. Accounting System

Sky Aviation Services, Incorporated operates on a calendar year basis. They do not maintain an acceptable job order cost accounting system for government contracts. The contractor does not accumulate costs by job nor does it segregate direct from indirect costs or develop indirect rates. In addition, the contractor does not isolate unallowable costs or maintain a general ledger to determine costs by account.

3. Estimating System

We have not performed an audit of the contractor's estimating system because the volume of proposals submitted by this firm does not warrant a systems review.

DCAA PERSONNEL

Primary contacts regarding this audit:

Dennis J. Skrocki, Auditor

Richard Tusman, Supervisory Auditor

Telephone No.

Other contacts regarding this audit report:

Edmond E. Slattery Jr., Branch Manager

Susan Hartman, Financial Advisor

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E-mail Address

General information on audit matters is available at <http://www.dcaa.mil/>.

RELEVANT DATES

Request for Audit: ACO - dated September 16, 2002; received September 17, 2002

AUDIT REPORT AUTHORIZED BY:

/S/

Edmond E. Slattery Jr.

Branch Manager

DCAA Pennsylvania Branch Office

Appendix:

Other Matters to be Reported

AUDIT REPORT DISTRIBUTION AND RESTRICTIONS

DISTRIBUTION

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RESTRICTIONS

1. Information contained in this audit report may be proprietary. It is not practical to identify during the conduct of the audit those elements of the data which are proprietary. Make proprietary determinations in the event of an external request for access. Consider the restrictions of 18 U.S.C. 1905 before releasing this information to the public.
2. Under the provisions of Title 32, Code of Federal Regulations, Part 290.7(b), DCAA will refer any Freedom of Information Act requests for audit reports received to the cognizant contracting agency for determination as to releasability and a direct response to the requestor.
3. The Defense Contract Audit Agency has no objection to release of this report, at the discretion of the contracting agency, to authorized representatives of Sky Aviation Services, Incorporated.
4. Do not use the information contained in this audit report for purposes other than action on the subject of this audit without first discussing its applicability with the auditor.

OTHER MATTERS TO BE REPORTED

Sky Aviation Services, Incorporated is subject to the Service Contract Act with award of the letter contract. This requires that they pay, at a minimum the Department of Labor base wage rates and certain benefits. However, they are not complying with the Service Contract Act as follows:

Wage Determination Number 1994-2449, Revision Number 15, dated June 7, 2002.

	Minimum Wage Rate	Health & Welfare Benefits	Total	Actual Rate	Difference
Guard 1	\$9.32	\$2.15	\$11.47	\$10.25	\$1.22